Vol 311

No. 360

Office - Supreme Court, U. S.
FILED
AUG 22 1940
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

OCTOBER TERM, 1940.

LONG ISLAND DRUG COMPANY, INC.,
Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION AND BRIEF FOR WRIT OF CERTIORARI.

OTHO S. BOWLING,
Counsel for Petitioner.

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OCTOBER TERM, 1940.

LONG ISLAND DRUG COMPANY, INC.,
Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

To the Honorable, the Chief Justice, and the Associate Justices of the Supreme Court of the United States:

This the petition of Long Island Drug Company, Inc., a domestic corporation organized under the laws of the State of New York, with its principal office at Jamaica, New York City, respectfully shows:

1. This is a petition for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

Two Cases on a Single Record.

2. *There are two cases tried and determined on a single record. The cases involved Petitioner's income tax returns for the years 1931 and 1932-1933. This petition is filed in the case concerning the 1931 tax* (B. T. A. Docket No. 75225). *A companion petition is being filed in the case concerning the 1932-1933 tax* (B. T. A. Docket No. 79616).

History of the Case.

3. Petitioner filed its petitions with the Board of Tax Appeals to redetermine deficiencies assessed against it by the Commissioner of Internal Revenue for income taxes for the year 1931 (Petition 1931; R. 5-12). This, together with the petition concerning the return for the years 1932-1933 (R. 14-25), was heard at a consolidated hearing. The Board handed down decisions determining that there were deficiencies as found by the Commissioner (R. 37, 38). The opinion of the Board is reported in 35 B. T. A. 328. Thereupon Petitioner filed petitions for review by the United States Circuit Court of Appeals for the Second Circuit (Petition 1931; R. 39-42). That court affirmed the determination of the Board (R. 137). The opinion of that court is reported in 111 Fed. (2d) 593. The opinion of the Circuit Court was handed down May 6, 1940. Its order is dated May 23, 1940. On May 21, 1940, within the time allowed by the rules of that court, Petitioner filed its petition for rehearing. On May 23, 1940, said court handed down its order denying the petition (R. 135).

Jurisdiction.

4. The Supreme Court has jurisdiction because this is a petition to review a United States Circuit Court of Appeals (Act of Feb. 13, 1925, 28 USCA §347). The petition for certiorari is filed within three months after the date of the order of affirmance and within three months after the denial of the petition for a rehearing (28 USCA §350; *United States* v. *Seminole Nation,* 290 U. S. 417, 421).

The Questions Relied On.

5. The case arose because Petitioner in its income tax returns for the years in question claimed, as deductions from gross income, the salaries paid four officers. These salaries were based upon fixed amounts, plus percentages of profits. Petitioner, before the Board of Tax Appeals, offered proof that the salaries paid, including percentages of profits, were reasonable. The Commissioner offered no proof. The Board of Tax Appeals, after reviewing Petitioner's proof, rejected it as insufficient on the ground that Petitioner had

> "* * * failed to sustain the burden of proof to show that respondent's determination was erroneous" (R. bottom p. 35).

These questions then arise:

A. When the taxpayer shows that the salaries of executives were arrived at in regular course of administration of the business, coupled with proof of the volume of business done and the duties performed, does not a presumption arise that the salaries so paid were reasonable, requiring some contrary evidence before the taxpayer's proof may be disregarded? The Circuit Court of Appeals for the Fourth Circuit so held (*Ox Fibre Brush Co.* v. *Blair,* 32 Fed. [2d] 42, 45), a decision which cannot be reconciled with this decision of the Circuit Court of Appeals for the Second Circuit.

This is a question of great general importance in the administration of the revenue laws. If the Board of Tax Appeals can ignore *all* the evidence of reasonableness, as it did here; if the Collector can slash salaries as he pleases without advancing any reason therefor; if his arbitrary judgment may be substituted for that of the managers of the business whose good faith is not attacked, then the taxpayer has no real remedy for capricious administrative action.

B. Is not the presumption that the determination of the Collector of Internal Revenue was correct, so as to require the taxpayer to produce some evidence to the contrary, a mere *procedural* presumption, which disappears when evidence is produced? The Circuit Court of Appeals for the Third Circuit (*Manchester Board & Paper Co., Inc.* v. *Commissioner of Internal Revenue,* 89 Fed. [2d] 315, 317) and for the Sixth Circuit (*Lunsford* v. *Commissioner of Internal Revenue,* 62 Fed. [2d] 740, 742) have so held. The Board of Tax Appeals apparently held the contrary because it based its decision on the theory that Petitioner had "failed to sustain *the burden* of proof *to show* that *respondent's determination* was erroneous" (our italics, R. 35), that is to say, it assumed that the presumption could be put in the scales against Petitioner's proof. If it had weighed respondent's proof it would have been compelled to make a finding as to reasonableness, which it did not do. True, the Circuit Court of Appeals interpreted what the Board said as "the equivalent of a specific finding that the compensation paid, over and above the amount allowed by the Commissioner as deductible, was unreasonably high" (R. 129), but we consider this interpretation erroneous, and it is contrary to the one advanced by the Assistant Attorney General in his brief. The Circuit Court of Appeals did not expressly disapprove of the cited decisions in the Third, Fourth and Sixth Circuits, but the result reached cannot be reconciled with them.

This also is a question of great general importance, a corollary to the question first defined, because if the presumption is merely procedural, then the Board of Tax Appeals must weigh Petitioner's uncontradicted proof, and not base a decision, as it did here, on the theory that a non-existent presumption of substance outweighed it. The Supreme Court, so far as our research reveals, has never passed on this point, and it is important to the administration of the revenue laws that it should.

6. Because the Circuit Court of Appeals for the Second Circuit erred in deciding the foregoing questions, because its decisions cannot be reconciled with the cited decisions of other circuits, and because the questions are of general importance, all of which matters are more fully expounded in the brief accompanying this petition, Petitioner prays that a writ of certiorari issue to the United States Circuit Court of Appeals for the Second Circuit, to the end that its error, if such there be, may be corrected.

Dated, August 20, 1940.

Respectfully submitted,

OTHO S. BOWLING,
Counsel for Petitioner.

I certify that, in my opinion, the foregoing petition is well founded and that it is not interposed for the purpose of delay.

OTHO S. BOWLING,
Counsel for Petitioner.